IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

No. 11419

PAUL JOHN HUNT,
Appellant,

vs.

SECURITIES AND EXCHANGE COMMISSION,
Appellee.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION.

BRIEF FOR APPELLEE

ROGER S. FOSTER,
Solicitor,

ROBERT S. RUBIN,
Associate Solicitor,

MILTON P. KROLL,
Special Assistant,

MYER FELDMAN,
Attorney,
Securities and Exchange Commission,
18th and Locust Streets,
Philadelphia 3, Pa.

Of Counsel:

JAMES E. NEWTON,
Securities and Exchange Commission,
1411 Fourth Avenue Building,
Seattle 1, Washington.

The Legal Intelligencer, 1218 Chestnut Street, Phila. 7, Pa.

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JURISDICTION

The basis for the jurisdiction of the District Court and of this Court is set forth in appellant's brief.

QUESTIONS INVOLVED

I. Where appellant sold unregistered securities to residents of several states in violation of Section 5(a) of the Securities Act of 1933, not being entitled to the exemption therefrom accorded to an issue sold only to residents of a single state, and hence has been enjoined from selling unregistered securities in interstate commerce, or by use of the mails, except as to securities or transactions exempted by the Act from Section 5 thereof—are his sales of securities of the same issue subsequent to the decree by the wholly intrastate use of the mails in contempt of that decree?

II. May appellant collaterally attack the permanent injunction in the course of a contempt proceeding by asserting that Congress has no power to regulate the intrastate use of the mails, that Section 5(a) of the Act is inapplicable to such use of the mails, and that Section 18 of the Act grants to the State of Washington sole jurisdiction over the sale of securities in that state, even though the mails are used in such sales? If so,-are these arguments valid?

STATUTE INVOLVED

The pertinent provisions of the Securities Act of 1933 are as follows:

Section 5(a), (15 U.S.C.A. §77e(a)):

> "Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—
>
> (1) to make use of any means or instruments of transportation or communication in interstate

commerce or of the mails to sell or offer to buy such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale."

Section 3(a) (11), (15 U.S.C.A. §77c(a) (11)) :

"Sec. 3(a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:

* * * *

(11) Any security which is a part of an issue sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory."

Section 18, (15 U.S.C.A. §77r) :

"Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or office performing like functions) of any State or Territory of the United States, or the District of Columbia, over any security or any person."

COUNTER-STATEMENT OF THE CASE

On or about January 1, 1940, appellant, Paul John Hunt, who resides and does business in the State of Washington, commenced selling certain securities pertaining to the assignment of oil and gas leases on land located in Yakima and Benton Counties, Washington, after procuring a license to sell securities from that state in October, 1939. Such sales were effected by the use of the mails and the instruments of interstate commerce and were made not only to residents of the State of Washington but also to residents of Idaho and California (R. 19). No attempt was made to

restrict such sales to residents of the State of Washington. At no time were the securities thus sold registered with the Securities and Exchange Commission as required by Section 5 of the Securities Act of 1933.

On February 18, 1946, the Commission applied to the District Court of the United States for the Western District of Washington, Northern Division, for an injunction restraining appellant from violating the provisions of Section 5 of the Securities Act of 1933 in the sale of such securities. It was alleged in the complaint that Hunt was and had been using both the mails and the means and instruments of transportation and communication in interstate commerce in effecting such sales and in delivering the securities after sale, in violation of Sections 5(a)(1) and 5(a)(2) of the Act because no registration statement was in effect with respect to such securities (R. 35-38). Hunt admitted the allegations of the complaint and consented to the entry of a decree pursuant to which he was enjoined from:

> "(a) making use of any means or instruments of transportation or communication in interstate commerce, or of the mails, to sell investment contracts, certificates of interest or participation in a profit-sharing agreement, fractional undivided interests in oil or gas rights, or interests or instruments commonly known as securities, arising out of or in connection with the sale of assignments of oil and gas leases on land located in Yakima or Benton Counties, Washington, or any other securities, through the use or medium of any prospectus or otherwise;
>
> "(b) carrying such securities or causing them to be carried through the mails or in interstate commerce, by any means or instruments of transportation, for the purpose of sale or for delivery after sale;
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> "unless and until a registration statement is in effect with the Securities and Exchange Commission as to such securities; provided that the foregoing shall not apply to any security or transaction which is exempt from the provisions of Section 5 of the Securities Act of 1933, as amended." (R. 6-8)

Affixed to the decree was the following consent signed by appellant and approved by his counsel:

> "The undersigned defendant, Paul John Hunt, having read and considered the provisions of the foregoing judgment, and admitting the jurisdiction of the Court over him and the subject matter of this action, and admitting the allegations contained in the complaint on file in this cause, consents to the entry of this judgment." (R. 8)

Despite this decree, appellant continued to sell the identical unregistered securities to which the complaint and decree related, using the United States mails within the State of Washington to acknowledge subscriptions, to forward the securities (R. 9-16), and to solicit additional subscriptions (R. 46-47).

The securities sold after the entry of the injunctive decree were identical in every respect with those sold prior to the decree, and were component parts of the same issue, all of them being sold as part of the same offering, issue, general plan of financing and for a single purpose (R. 20). On June 4, 1946, in response to an application by the Commission, an order to show cause why Hunt should not be held in criminal contempt for his actions subsequent to the entry of the injunction was granted (R. 17-18), and a hearing held (R. 41-60). Prior to the hearing, appellant signed a stipulation admitting the facts set forth above.

After the hearing, the Court adjudged Hunt in contempt and fined him $400 (R. 30-32). This appeal is taken from that judgment.[1]

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[1] The Securities and Exchange Commission is designated herein as the "appellee"; it is rather the "relator" which called the facts constituting the contempt to the attention of the court. James E. Newton, of counsel herein, an attorney on the staff of the Commission, was appointed by the court to present the contempt case on behalf of the court (R. 2).

ARGUMENT

In considering the issues here presented it is important to keep in mind the regulatory pattern of the Securities Act of 1933.[2] The Act is designed to protect the investing public. It is primarily a disclosure statute which requires the seller to disclose pertinent information concerning securities publicly offered and sold through the mails or in interstate commerce, so that investors may be in a position to exercise an informed judgment as to such securities.

Issuers of securities are required to file a prescribed "registration statement" with the Commission and to provide investors with a "prospectus" containing certain of the information in the registration statement. Section 5(a) of the Act makes it unlawful to sell unregistered securities by the designated means; and Section 17(a) deals with fraud in the sale of securities. Under Section 20(b), the Commission is authorized to bring proceedings to enjoin violations and to refer wilful violations to the Department of Justice for prosecution.

It should be noted, moreover, that under the Act the Commission does not regulate the business of the issuer of securities or pass upon the merits of security offerings. The only prerequisite to registration is complete and accurate disclosure of the facts. See Section 23 of the Act, which makes it unlawful to represent, in respect of a registered security, that the Commission has "passed upon the merits of, or given approval to, such security."

Section 5 of the Act flatly prohibits the use of the mails or means of interstate commerce in the sale of unregistered securities. However, in other portions of the Act exemptions from Section 5 are provided. Of course, the conditions set

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[2] Copies of the Act and of the Rules and Regulations adopted under it are being filed herewith for the convenience of the Court.

forth in these exemptive provisions must be met if they are to be utilized. Thus, a conditional exemption is provided in Section 3(a)(11) for any security which is sold only to persons resident within the state in which the issuer resides (or is incorporated) and does business. Section 4(1) of the Act provides an exemption from registration for transactions not involving a "public offering" of securities.

Section 3(b) gives the Commission the power to adopt exemptive rules in certain limited areas where it is appropriate in the public interest. Pursuant thereto the Commission has promulgated rules exempting under prescribed conditions offerings of securities the aggregate amount of which does not exceed $300,000 in any twelve-month period. See Regulation A (Rules 220 to 224) of the Rules and Regulations under the Act. This exemption is available for certain types of securities upon filing with the Commission of certain brief information as well as copies of the sales literature; it is generally not available for oil and gas securities because offerings of such securities present unusual opportunities for fraud. The Commission in Regulation B (Rules 300-356) of the Rules and Regulations has adopted another exemption for offerings of oil and gas securities which do not exceed $100,000, with somewhat different provisions as to disclosure. In general these regulations are designed to inform the Commission of the existence of these offerings in order that it may safeguard the public against fraud. At the same time in view of the nature of the offerings it was felt desirable to simplify the disclosure requirements as much as possible.

It thus will be noted that compliance with the Act can readily be effected either by registering the securities or by conforming to the terms or conditions of one of the various exemptive provisions contained therein. Appellant did neither.

I. APPELLANT'S SALES OF SECURITIES EFFECTED AFTER THE INJUNCTIVE DECREE BY THE WHOLLY INTRASTATE USE OF THE MAILS WERE IN CONTEMPT OF THAT DECREE.

a. *The Injunction Entered on February 18, 1946, Clearly Included Within Its Prohibitions Sales by the Intrastate Use of the Mails.*

The bill of complaint filed by the Commission against appellant sought to restrain him from violating Sections 5(a)(1) and 5(a)(2) of the Act. The request for relief was phrased in the language of Section 5(a) of the Act, and asked that Hunt be enjoined against both the use of interstate channels and the use of the mails in connection with his sales activities. The decree, to which Hunt consented and which his counsel approved, was phrased in the identical words used by the Commission in its request for relief. The Act, the complaint, and the decree all refer to the sale of unregistered securities by the "use of any means or instruments of transportation or communication in interstate commerce *or* of the mails . . ." (emphasis supplied). Despite this clear and unmistakable language, appellant has chosen to read the disjunctive "or" as a conjunctive "and", contending that the decree is applicable only to interstate commerce, and that the use of the mails intrastate is not included within its scope.[3]

Such a construction would render the words "or of the mails" surplusage, for it is obvious that an interstate mailing would be a use of the "means or instruments of

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[3] Throughout his brief, appellant urges a variety of arguments dealing with the alleged impropriety of the regulation of the intrastate use of the mails. Since an analysis of these objections reveals that in substance they constitute a collateral attack upon the original decree, we have treated them *infra* at pp. 12-15. If the court should consider these arguments as relevant to a consideration of the construction of the decree, that discussion is applicable here.

transportation or communication in interstate commerce," which is set forth as the alternative prohibition in the decree. Since the decree specifically forbids the use of means or instrumentalities of interstate commerce in effecting sales of securities, it is clear that the contention of appellant must be rejected if the phrase "or of the mails" is to be accorded any meaning.

As we have noted, the Act itself provides that persons who do not comply with the provisions of Section 5 are to be deprived both of the right to use any means or instruments of transportation or communication in interstate commerce and of the right to use the mails. Appellant's argument is equally applicable to the words of the Act and would strip from it the jurisdiction which Congress exercised over the mails, thus affecting Sections 5(a), 5(b), 12(2), 17(a), and 17(b), all of which deal with interstate commerce and the mails in the alternative. Thus, reference to the Act itself shows the complete lack of merit in appellant's construction.[4]

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[4] Any possible doubt as to the meaning of Section 5(a) is resolved by the legislative history of that provision. As originally introduced it forbade "any person to make use of the United States mails or of any means or instruments of transportation or communication to offer in *interstate commerce* securities . . . for sale or to solicit or accept offers to buy such securities in such commerce . . . or to carry or cause to be carried in *interstate commerce* . . . any security . . ." (Emphasis supplied). H.R. 4314, 73d Cong., 1st Sess.; S. 875, 73d Cong., 1st Sess. When the language was changed to its present form the intention of Congress to enlarge the scope of the bill to include the intrastate use of the mails was made patent by its change in the preamble to the Act. Thus, the original preamble, which stated the bill was designed "to provide for the furnishing of information and the supervision of traffic in investment securities in interstate commerce," was changed to read: "A bill to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails."

That the draftsmen of the latter bill recognized that the provisions thereof would extend to sales consummated entirely within a single state if the mails were used in that state, is made clear by the insertion therein of Section 5(c), the present

Moreover, this interpretation was considered and rejected by this Court in *Shaw* v. *United States*, 131 F. 2d 476, 480 (C.C.A. 9, 1942):

> "Appellant also contends that the carriage of the securities through the mails from one point in Los Angeles County to another is not the use of the mails in violation of the Securities and Exchange Act. There is no merit in this contention. The pertinent portion of the Act creating the offense reads 'to carry or cause to be carried through the mails *or* in interstate commerce . . .' The 'or' is disjunctive and the carriage through the mails is an element of the offense even though the carriage be intrastate."

Accord: *Securities and Exchange Commission* v. *Boise Petroleum Corp.* (D. Idaho, No. 1974, July 7, 1937, unreported) 1 S.E.C. Jud. Dec. 395. See also *Securities and Exchange Commission* v. *Timetrust, Inc.*, 28 F. Supp. 34 (N.D. Calif. 1939) and *United States* v. *Alluan*, 13 F. Supp. 289, 292 (N.D. Tex. 1936).

In view of the plain words of the decree framed in conformity with the language of the statute, both of which clearly apply to intrastate use of the mails as well as their use interstate, it is evident, we submit, that the decree prohibited appellant from making use of the mails in any way in selling unregistered and non-exempt securities, and that appellant's activities subsequent to the decree were in violation of it, since the only exemption contended for, that accorded by Section 3(a) (11), is unavailable, to which question we now turn.

Section 3(a) (11) of the Act, which exempts wholly local issues from registration. Under the original draft such a provision was of course unnecessary for only interstate commerce was regulated.

b. *The Exemption from the Provisions of Section 5 of the Securities Act Contained in Section 3(a)(11) is Not Available if Any Part of the Issue Involved is Sold to Non-Residents.*

Prior to the entry of the injunction appellant engaged in the sale of unregistered securities to residents of several states by use of the mails and by use of instrumentalities of interstate commerce. In consenting to the injunction appellant acknowledged the unavailability of any exemption for these securities.[5] Nevertheless, and despite the fact that appellant has admitted that the securities sold prior to the injunction and those sold thereafter were identical and parts of the same issue, and that certain of the securities comprising the issue were sold to non-residents of the state in which he was doing business, he now urges that the sales since the date of the injunction were entitled to the exemption from registration provided in Section 3(a) (11) of the Act, which exempts "any security which is part of an issue sold only to" residents of a single state. In so urging, appellant maintains that this exemption applies to any part of an "issue" of securities which is sold intrastate, even though other portions of that same issue are sold to residents of other states. The plain language of the Act negatives such a construction.

Section 5(a) of the Act is sufficiently broad to include within its scope all securities sold by means of the instrumentalities of interstate commerce or by any use of the mails. However, Section 3(a) (11) which was originally Section 5(c), removes from the operation of this section those security offerings which are consummated *in their entirety* within the state in which the issuer is resident (or incorporated) and doing business. The exemption is so

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[5] The injunction provided that its prohibitions should not apply "to any security or transaction which is exempt from the provisions of Section 5 of the Securities Act of 1933, as amended" (R. 7).

worded as to be available only to a security "which is a part of an issue sold only to persons resident within" the state in question. Once *any part of the issue* is sold to a person outside that state, the status of the offering as a wholly intrastate issue disappears and the exemption becomes unavailable for any securities of that issue. See *Shaw* v. *United States*, 131 F. 2d, at p. 480.

The pertinent language of Section 3(a)(11), which restricts the exemption to issues "sold *only* to persons resident within a *single* State" could not be more unequivocal. Moreover, it is manifest from the legislative history of the section that Congress clearly intended that when any part of a securities issue was offered or sold to a resident of a state other than that in which the issuer was resident (or incorporated) and doing business, the entire issue would lose its local character, and the exemption provided by Section 3(a)(11) would be inapplicable. The House Committee Report commented on this section as follows:

> "Section 5(c) [now section 3(a)(11)] also exempts sales within a state of *entire* issues of local issuers." [6] (Emphasis supplied.)

When Section 3(a)(11) was adopted the House Committee Report repeated this limitation, stating:

> "The new Section 3(a)(11) incorporates the existing Section 5(c) of the Act and further makes clear that the exemption is not limited to the use of the mails, if sales in the course of the distribution of the issue are limited to residents within a *single* state or territory." [7] (Emphasis supplied.)

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[6] H.R. 85, 73d Cong., 1st Sess., p. 7.

[7] H.R. 1838, 73d Cong., 2d Sess., pp. 40-41. Section 5(c) exempted sales of such securities from only those provisions of Section 5 of the Act which related to the use of the mails. It gave no exemption from provisions relating to the use of any means or instruments of transportation or communication in interstate commerce. In replacing Section 5(c) with Section 3(a)(11) Congress made it clear that where its terms and conditions were complied with the exemption would apply to all of the provisions of Section 5 including the use of interstate channels.

Therefore, in view of the plain language used and of the legislative history of Section 3(a)(11), it is apparent that the exemption provided by that section is not available if any part of the issue is sold outside the state in which the issuer is resident (or incorporated) and doing business.[8] By stipulation it is conceded that the issuer, appellant herein, was doing business in the State of Washington; that some sales were made to residents of other states; and all sales were of securities which were parts of a single issue. Thus, the exemption provided by Section 3(a)(11) is clearly unavailable to appellant.

The District Court considered all of the facts as to appellant's activities both before and after the decree, the circumstances under which the decree was entered and also the suggestion that appellant in conducting his sales activities since the entry of the injunctive decree had acted in reliance upon advice of counsel. It is clear that the Court's conclusion that appellant knowingly and intentionally violated the injunctive decree of February 18, 1946 was amply supported by the record.

II. APPELLANT MAY NOT ATTACK THE VALIDITY OF THE INJUNCTION IN THIS ACTION.

As we have demonstrated, the injunction clearly prohibited appellant from using the mails in selling unregistered securities. Notwithstanding that appellant consented to the entry of this injunctive decree, he now for the first time seeks to question its validity. He asserts that the Congress has no power to regulate the use of the mails in connection with a wholly intrastate business; that Section 5 of

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[8] The burden of establishing that a person is within a class excepted from the disclosure requirements of the Act, as this Court has held, is upon the person asserting the exemption. *S.E.C.* v. *Sunbeam Gold Mines Co.*, 95 F. 2d 699 (C.C.A. 9, 1938); *Edwards* v. *United States*, 113 F. 2d 286, 289 (C.C.A. 10, 1940) rev'd on other grounds, 312 U.S. 473, although sustained on this point (at p. 483).

the Act does not encompass transactions involving the intrastate use of the mails; and that Section 18 of the Act prohibits the court from restraining the intrastate use of the mails. All of these arguments constitute attempts to establish the impropriety and invalidity of the original decree enjoining appellant. As such, they may not be urged upon appeal from a judgment for contempt of that decree. *Western Fruit Growers, Inc.* v. *Gotfried*, 136 F. 2d 98, 100 (C.C.A. 9, 1943); *Clarke* v. *Federal Trade Commission*, 128 F. 2d 542, 543 (C.C.A. 9, 1942); *E. Ingraham* v. *Germanow*, 4 F. 2d 1002, 1003 (C.C.A. 2, 1925). Only by direct appeal may the propriety of the injunction be tested.

Thus, the Supreme Court, in *Howat* v. *Kansas*, 258 U. S. 181, 189-190, stated:

> "An injunction duly issuing out of a court of general jurisdiction with equity powers upon pleadings properly invoking its action, and served upon persons made parties therein and within the jurisdiction, must be obeyed by them however erroneous the action of the court may be, even if the error be in the assumption of the validity of a seeming but void law going to the merits of the case. It is for the court of first instance to determine the question of the validity of the law, and until its decision is reversed for error by orderly review, either by itself or by a higher court, its orders based on its decision is contempt of its lawful authority, to be punished."

In any event we regard the objections to the original injunctive decree now urged by appellant as being without merit. Insofar as appellant questions the power of Congress to forbid the use of the mails intrastate, his position clearly is untenable. We submit that there can no longer be any question as to the power of Congress to forbid the use of the mails for purposes which it deems contrary to public policy, even though the activity affected may be confined to a single state.[9]

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[9] *Ex parte Jackson*, 96 U.S. 727; *In re Rapier*, 143 U.S. 110. *Public Clearing House* v. *Coyne*, 194 U.S. 497; *Grimm* v. *United States*, 156 U.S. 604; *Lewis Publishing Co.* v. *Morgan*,

Appellant also contends that Section 5(a) of the Act is not applicable where the only use of the mails is intrastate. We already have discussed this question in connection with our analysis of the injunctive decree, which follows the language used in Section 5(a).[10] We believe that discussion fully answers this contention.

Finally, appellant advances the theory that the license to do business which he obtained from the State of Washington vested him with the right to conduct an intrastate business and to use the mails intrastate in furtherance of that business, regardless of the restrictions upon that right contained in the Securities Act. He bases this contention upon Section 18 of the Act, which provides:

> "Nothing in this title shall affect the jurisdiction of the Securities Commission (or any agency or office performing like function) of any State or Territory of the United States, or the District of Columbia, over any security or any person."

It appears that Section 18 was enacted in order to preserve the jurisdiction of state security commissions over transactions within their borders,[11] and not to limit the jurisdiction of the federal regulatory body. By enacting Section 18 Congress indicated that concurrent jurisdiction might be exercised over certain activities, but there is no indication there, or in any other portion of the Act, that Congress sought to withdraw from federal regulation so important an area as that which embraces the sale of securities intrastate through use of the mails. Appellant's claim of sanctuary under Section 18 was also suggested by the defendant in *S.E.C.* v. *Timetrust, Inc., et al.*, 28 F. Supp. 34 (N.D. Calif., 1939), an action under Section 17 of the Act. There the court, in rejecting this claim, stated (at p. 41):

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299 U.S. 288; *Badders* v. *United States*, 240 U.S. 391, 393; *Electric Bond & Share Co.* v. *S.E.C.*, 92 F. 2d 580, 583 (C.C.A. 2, 1937), *affirmed* 303 U.S. 419.

[10] *Supra* pp. 7 to 9.

[11] See H.R. 85, 73d Cong., 1st Sess., pp. 10-11.

> "There is no merit in the contention. The most that can be said for the section is that it probably gives concurrent jurisdiction to the Securities and Exchange Commission and the State authorities."

The objections urged by appellant, therefore, whether considered as a collateral attack upon the injunctive decree or upon any other basis, must fall in view of the authorities heretofore cited as well as the plain language of the Act.

CONCLUSION

For the reasons stated, it is apparent that appellant violated the injunctive decree of February 18, 1946 and was properly held in contempt thereof. Accordingly, the decision of the District Court should be affirmed.

Respectfully submitted,

ROGER S. FOSTER,
Solicitor,

ROBERT S. RUBIN,
Associate Solicitor,

MLITON P. KROLL,
Special Assistant,

MYER FELDMAN,
Attorney,

Securities and Exchange Commission,
18th and Locust Streets,
Philadelphia 3, Pa.

Of Counsel

JAMES E. NEWTON,
Securities and Exchange Commission,
1411 Fourth Avenue Building,
Seattle 1, Washington
December, 1946.